Colombia: CAS Progress Report and Financial Sector Adjustment Loan

1. The Government of Colombia is facing a daunting array of challenges to restore sustainable economic growth, reduce poverty, and meet the aspirations of its people for peace. We share President Pastrana's assessment that a comprehensive, integrated strategy is the best way to confront these interlocking challenges. The Government's National Development Plan and its new Plan Colombia strategy respond to this need. With their emphasis on protecting and building social capital, improving access of the poor to public goods, and placing more decisions in the hands of those who will be most affected by them, these plans are built on substantial input from civil society and stand to receive broad public support. We commend Bank staff and management for responding quickly to the Pastrana Government's new plans and initiatives by preparing the CAS Progress Report and the Financial Sector Adjustment Loan.

2. The Government has already taken significant steps to implement the reforms and initiatives envisioned in the Plan. It has passed legislation to improve public finances. Its initial responses to banking system weakness -- including the steps to intervene failing private banks and sanction managers of the failed publicly-owned banks -- have been timely and effective. It has obtained the Bank's and Transparency International's assistance to help its Anti-corruption Commission develop effective strategies. It has sought the support of the IMF for a three-year Extended Financing Facility (EFF). The Government has also developed new programs to use public resources more efficiently to deliver key social services to the poor, while also increasing their employment opportunities. The market has already begun to reward these encouraging developments with falling interest rates, which the Progress Report correctly identifies as vital to the success of the Government's economic recovery program.

3. Of course, much remains to be done in these and other policy areas to restore sustainable, equitable economic growth. Carrying through on fiscal reform measures that are to be supported...
by the EFF is crucial, particularly the measures to rationalize the constitutionally-mandated transfers to Departments and municipalities. Greater efforts to improve the investment climate will also be required. Ensuring full transparency of the privatization process, strengthening the judicial system, making visible progress in combating corruption, and facilitating conditions for job creation are all needed to achieve the Government's ambitious target for attracting $3.5 billion in foreign direct investment next year.

4. Commensurate with the Government's commitment to, and progress in, restoring sustainable and equitable economic growth, the Government and the people of Colombia deserve our support. My authorities are currently reviewing how they can best support Plan Colombia. Here, today, we support both the Bank's strategy as outlined in the CAS Progress Report and the proposed Financial Sector Adjustment Loan, although we have some qualifications and observations to which I will return. We especially welcome the intention to introduce social safety net and social sector adjustment loans. The sobering data regarding the incidence and distribution of poverty and unemployment document the need to mitigate the immediate effects of the recession and continuing unrest on the vulnerable, as well as address structural issues of social protection. Our more specific comments on the CAS Progress Report and the Financial Sector Adjustment Loan follow.

5. We agree that a number of factors justify an increased lending program. Chief among these is the Government's commitment to and progress on reform. However, the fact that the Bank's net disbursements to Colombia have been negative in recent years does not in and of itself contribute to this justification. The level of these disbursements has been primarily a function of the Colombian authorities' own choices with respect to economic policy, sources of external finance, and project implementation.

6. We are concerned that the CAS Progress Report lacks objectively verifiable triggers that clearly identify expectations with respect to the policy reforms, initiatives, and outcomes to justify each level and type of lending. Paragraphs 57 and 65 point towards some possible conditions, but lack clarity and precision. Implementation of the macroeconomic and fiscal and financial sector structural reforms to be supported by the IMF's EFF should surely be a condition of the high lending case. Indeed, we would normally have wished to see IMF Board approval of the EFF before reviewing the Financial Sector Adjustment Loan. Strong performance of the Bank's own portfolio and measurable effectiveness of Government social spending programs in reducing poverty should also be conditions. Likewise, progress on strengthening the Government's financial management and accountability, combating corruption, reforming the judiciary, and privatizing public financial institutions and enterprises should be conditions for the high case. We would appreciate staff's proposals for explicit triggers built on these and other appropriate elements. We would have appreciated seeing in Annex B3 an explicit identification of which operations are APLs and LILs and would like to signal here that we believe that all stage-I APLs should be brought to the Board under regular procedures.

7. We regret that the Progress Report does not outline what critical diagnostic assessments
were conducted to ensure the accountability and effectiveness of the proposed large amounts of fast-disbursing assistance. We welcome staff's supplemental information that Country Procurement and Financial Management Assessments were done in 1997 and 1998, respectively, but would appreciate further information on how the results of these two assessments influenced the design of the expanded lending program. In addition, a Public Expenditure Review, which the Bank's own operational procedures indicate should be a condition for an adjustment loan, has not been done. This kind of work is also a necessary part of the analytical underpinning of the proposed second Public Financial Management Loan. We would appreciate clarification from staff as to their plans in this regard.

8. In contrast, the Progress Report provided a good outline of the analytical and diagnostic work -- including the social sector assessment, poverty update and employment generation study -- that is to feed into the design of the proposed Social Safety Net Project and the Social Sector Adjustment Loan. We would like Management's assurances that, consistent with commitments made at the time of the Board's approval of the Bank's FY 2000 budget, this work is fully funded. We would also note that success of the structural changes depends critically on successful implementation of other public sector reform programs, especially performance-based budgeting and decentralization, which are to be supported by the Bank and the Inter-American Development Bank.

9. On the environment front, we urge strong collaboration among the authorities, the Bank, and the Fund to ensure that necessary fiscal consolidation does not adversely affect Colombia's positive achievements to date. We understand the Government's request to reprogram the undisbursed balance of the Bank's urban environmental loan to meet urgent earthquake construction needs. However, we are concerned that the planned cancellation of the Bank's rural development loan may reflect a diminishing priority on strengthening environmental institutions and implementing standards. There are no new environmental loans in the Bank's pipeline. Instead, the small-scale environmental activities mentioned in the Progress Report are to be financed by grants from the Global Environment Fund. We understand the explanation that staff shared for this move, including the difficulty that the Government itself has in implementing environmental programs in some regions. However, this shift to GEF funding in no way sets a precedent. We will continue to look carefully at the Bank's overall efforts to mainstream GEF objectives in its regular loan and credit operations.

10. We also welcome the Government's and the Bank's creative use of NGOs to implement agreed social and environmental programs. We would appreciate clarification from Bank staff as to the controls that it and the Colombian authorities have put in place to monitor NGOs' execution of programs and projects, particularly in geographic areas that Bank and perhaps Government officials do not enter.

11. The Progress report notes that "the Fund program may prove difficult to implement due to labor union resistance to reform measures." However, there is no analysis to support this statement. We would urge the Bank and the Government to review the social safety net programs, the job creation programs, and the extensive process of civil society consultation to
see whether modifications are desirable and feasible to help address organized labor's concerns. We understand that the ILO may create a Commission of Inquiry to look into the violence against trade unionists in Colombia as well as legal impediments to freedom of association. If so, we would also urge that the findings of this inquiry be fed into the overall peace and development strategy.

12. The Progress Report would benefit from a table showing the Inter-American Development Bank's existing and planned projects in Colombia. We understand that the Bank and the IDB will be conducting joint social sector missions. This kind of cooperation contributes both to ensuring the consistency of the two institutions' advice and to reducing the burden on the authorities. However, our reading of the CAS Progress Report leaves us with the impression that donor coordination consists primarily of cost-sharing. For example, we understand that both the Bank and the IDB are planning financial sector, public sector, and social sector reform operations. We would appreciate Management's views on how the Bank has identified its comparative advantage and is exercising strategic selectivity in Colombia.

13. We strongly support the proposed Financial Sector Adjustment Loan. The Government has completed an impressive list of actions prior to presentation of this loan to the Board. The conditions established for second tranche release are appropriate. We would underscore here the important link between resolving the problems of the financial sector, getting the Colombian economy back on the path to sustainable growth, and reducing poverty. A strong financial sector is essential to lowering the cost of capital in the economy, not just for large enterprises, but for SMEs and microenterprises as well. Renewed access to affordable credit is essential to promote investment, job creation, and higher incomes, including for the poor. In addition, resolving the problems of the cooperatives and the S&Ls will directly benefit the poor. As a final observation, we believe that this loan is the first fixed spread loan to be considered by the Board. The loan is denominated in Euros. The repayment terms are fairly standard -- 17 years maturity, including 5 years grace after which level payments of principal will begin. We understand that the Government elected these terms because they are underweight in non-dollar liabilities and in fixed rate debt. It would be useful for future loan documents for fixed rate loans to include a paragraph or two on the borrower's rationale for its election of the currency composition and repayment terms. This transparency could beneficially affect countries' sovereign asset liability management.